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UNCLAS SECTION 01 OF 05 TOKYO 000821

SIPDIS

SENSITIVE
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DEPT FOR EAP - AMBASSADOR HASLACH
DEPT ALSO FOR EAP/J AND EEB/OIA
DEPT PASS USTR FOR CUTLER, BEEMAN, KALLMER
NSC FOR TONG
TREASURY DEPT FOR DAS NOVA DALY, AND IA/CARNES
JUSTICE FOR ANTITRUST DIVISION - CHEMTOB
USDOC FOR 4410/ITA/MAC/OJ
GENEVA FOR USTR

E.O. 12985: N/A
TAGS: [EINV](#) [ECON](#) [OECD](#) [JA](#)
SUBJECT: INVESTMENT WORKING GROUP TARGETS JAPAN'S DETERIORATING
INVESTMENT CLIMATE

Sensitive but Unclassified - Not for the Internet

¶1. (SBU) Summary: There is no change in Japan's policy of promoting foreign direct investment (FDI), according to the Japanese co-chair of the U.S.-Japan Investment Working Group (IWG), which met March 17 via digital videoconference. The GOJ will continue to showcase Japan as an investment destination, through seminars and enhanced outreach programs. The IWG agenda this time included two new items -- the deteriorating global investment climate and Japan's M&A regime. Treasury officials briefed the group on the new Foreign Investment and National Security Act, which reformed the U.S. CFIUS process. Japan agrees with the U.S. that investment security reviews should be focused narrowly -- important in light of recent discussions of a possible law to limit foreign investment in Japanese airports. METI and MOFA officials stated, except for one recent case, the GOJ has approved all investment applications in sensitive sectors in under 30 days. Both sides agreed to continue the IWG's business outreach efforts and the U.S. put forward a proposal for a seminar to examine differing U.S. and Japanese attitudes toward M&A. The IWG will prepare a joint report for submission to the President and Prime Minister in time for their expected meeting on the margins of the G-8 summit. End Summary.

¶2. (U) The U.S.-Japan Bilateral Investment Working Group met via digital videoconference March 17. State Department East Asia and Pacific Affairs Bureau Economic Coordinator, Ambassador Patricia Haslch, chaired the U.S. side from Washington. The GOJ co-chair in Tokyo was Ministry of Economy, Trade and Industry (METI) Deputy Director-General for Trade and Economic Cooperation Nobuhiko Sasaki. Paragraphs 18-19 contain full lists of the participants.

Impact of Deteriorating Global Investment Climate

13. (SBU) Ambassador Haslach acknowledged Japan increased its FDI stock almost 20 percent in 2007, including through a record number of inward M&A transactions targeting Japanese firms. She noted the concerns, however, that some observers have expressed over recent GOJ proposals to limit foreign investment in newly privatized airport operators. Japan's challenge at this time of bearish financial market sentiment worldwide is to retain the confidence of the investor community, Haslach concluded, and one way to do this would be for senior Japanese policymakers, including Prime Minister Fukuda, to reaffirm publicly the government's pro-FDI policies.

14. (SBU) Sasaki stated there was no change in the GOJ's policies to promote inward foreign investment. The Prime Minister had reaffirmed the GOJ's target of raising FDI stock to the equivalent of 5 percent of GDP by 2010 at the January World Economic Forum in Davos, he noted. In order to accelerate progress toward that target, the GOJ has also established an Eminent Persons Investment Council, under the Cabinet Office, whose members includes the president of American Chamber of Commerce (ACCJ) and the chairman of the European Business Council, to examine concrete measures the government can take to increase inward investment. This committee will report to the Council on Economic and Fiscal Policy (CEFP), chaired by the Prime Minister, and its deliberations will be reflected in the annual Basic Economic Policy White Paper, which the Cabinet will issue in June. The government will continue its efforts to showcase Japan as an investment destination, through seminars and enhanced outreach programs, and explain to investors that Japan welcomes FDI.

Security Related Investment Reviews

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15. (SBU) Treasury's Deputy Assistant Secretary for Investment Security Nova Daly briefed the working group on the Foreign Investment and National Security Act (FINSA), which President Bush signed into law in July 2007. DAS Daly also noted the President signed an additional executive order in January 2008 strengthening the CFIUS process and imposing new disciplines by assigning designated responsibility to specific CFIUS agencies. The U.S. will issue additional regulations later this spring to clarify further the process. In the USG's view, security examinations of inward FDI should be limited to the actual risks posed by a specific transaction. If a transaction raises national security sensitivities, the U.S. will try to address the problem through effective mitigation, such as divestment of sensitive subsidiaries. DAS Daly agreed to stay in touch with METI as FINSA implementation proceeds. Although the public comment period on the new rules closed in December, the USG will again solicit comments when new implementing regulations are issued in April 2008.

16. (SBU) DAS Daly underscored the CFIUS process is explicitly designed to avoid excessive restrictions on FDI. Such investment is vital to the U.S. economy, with foreign owned firms accounting for 6 percent of U.S. GDP, 14 percent of U.S.-based R&D spending, and 19 percent of U.S. exports. Following the controversial Dubai Ports case, DAS Daly noted, President Bush had issued a statement reiterating the USG's commitment to welcoming FDI, the first Presidential statement on investment in 19 years. In 2007, out of nearly 2000 inward FDI cases, only 147, or about 8 percent, were reviewed under CFIUS. Historically, the annual ratio of CFIUS cases to total cross-border M&A transactions was even lower, running 5-6 percent.

17. (SBU) Kawakami briefed the IWG on Japan's system of security reviews. Japan agrees a minimal level of security-related regulation helps promote foreign investment. For that reason, he said, Japan's 1991 Foreign Exchange and Foreign Trade Control Law, as amended through a 2007 Cabinet Order, covers a narrow set of sensitive sectors. Foreign investment in those sectors above a specified level is subject to prior notification and approval. In the past three years, investors have submitted approximately 700 prior notifications and, except for the pending application by UK-based Children's Investment Fund to increase its stake in electric power wholesaler J-Power, the GOJ approved all applications

in less than 30 days.

M&A Related Issues

¶18. (SBU) Justice Department Special Counsel for International Trade Stuart Chemtob noted both Japanese and foreign experts have expressed concerns that recent Japanese court cases have caused confusion among investors about the proper use of defensive measures. More than 400 listed companies have adopted defensive measures in the past three years. The rise in cross-shareholdings as a de facto takeover defense is especially worrying because, unlike formal defense measures, company boards do not need to obtain shareholder approval for these purchases. Consequently, there is no effective check on board actions and no way to ensure that the purchases enhance corporate value. The U.S., Chemtob added, is not alone in its concerns. Tokyo Stock Exchange President Atsushi Saito in December 2007 criticized the practice of cross-shareholdings and non-transparent third-party allotments as a possible conflict of interest on the part of corporate boards. Chemtob expressed hope METI or its Corporate Value Study Group (CVSG) would examine the impact of these developments on corporate value and Japan's climate for M&A.

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¶19. (SBU) METI's Director of the Corporate Systems Division Hiroaki Niihara explained METI does not have direct authority to control adoption of defensive measures or cross-shareholding. Nor does the CVSG have the competence to recommend changes to law, although it can examine the appropriateness of defensive measures and the impact on corporate value. With that caveat, Niihara continued, he personally shares U.S. concerns about the confusion resulting from recent court rulings. The CVSG's 2005 recommendations on the use of defensive measures were based on the assumption these measures would serve only to suspend temporarily progress on an unsolicited takeover bids to give all parties time to determine whether they are in the best interests of the company. However, when the Japanese firm, Bull-Dog Sauce Co. implemented a poison pill defense in July 2007, paying out 2.1 billion yen to the U.S.-based hostile acquirer, it raised serious concerns about the impact of such actions on corporate value. Niihara said he hoped the Cabinet Office investment group would take up these issues.

¶10. (SBU) Niihara also agreed most cross-shareholdings lack adequate transparency. However, he attributed the rise in this behavior by Japanese listed companies to the confusion over proper use of formal defensive measures. He agreed on the need for greater transparency for all defensive measures and said METI would work to that end. He advised the USG to raise these issues in the annual Regulatory Reform Initiative. Chemtob assured him the USG had done so in the past and would continue to do so.

¶11. (SBU) Niihara noted further that, despite the rise in defensive measures, the total value of foreign acquisitions of Japanese companies in 2007 was 3.019 trillion yen, up 380 percent over 2006, and the number of such cases, 308, was an all-time high for inward M&A in Japan. He also observed only 10 percent of companies listed in Japan have adopted defensive measures, compared to 40 percent of U.S. listed companies. It was unlikely, he asserted, this figure will increase significantly.

Business Outreach

¶12. (SBU) Both sides expressed satisfaction with past business outreach programs. Ambassador Haslach tabled a proposal for the IWG to sponsor a seminar to examine differing attitudes toward M&A among Japanese and U.S. executives. Sasaki agreed METI would discuss the USG proposal with interested parties and suggested the IWG also examine new outreach targets, including Tokyo-based offices of U.S. state governments.

Bilateral Investment Treaties

¶13. (SBU) Following up on a formal "information exchange" on bilateral investment treaties (BITs) by an IWG experts committee in February 2007 and a subsequent informal exchange of views, METI Americas Division Director Noriyuki Mita briefed the IWG on changes to Japan's BIT policy. Previously, Japan had focused on building a network of Economic Partnership Agreements (EPAs) that covered trade as well as investment. However, the GOJ has begun to recognize many of its trading partners were not ready for a full EPA while Japanese companies were pushing for greater protection of their overseas investments. Japan, therefore, is increasing the list of countries with which it is considering negotiating BITs.

¶14. (SBU) The GOJ has already initiated discussions with Uzbekistan, where Japanese companies were increasingly making resource sector investments, and will likely announce opening of negotiations with Peru soon. The fourth round of negotiations

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between Japan, China, and the Republic of Korea on a trilateral BIT took place in early March, but progress remains slow. The Japanese side expressed interest in hearing about the U.S. experience negotiating with China and understood that the USG experiences many of the same challenges Japan faces.

¶15. (SBU) The State Department's Office of Investment Affairs BIT Coordinator Michael Tracton briefed the IWG on recent developments in discussions with China. The U.S. and China agreed to begin discussions on a possible BIT at the bilateral Strategic Economic Dialogue meetings in December 2007. Since then, two rounds of meetings had taken place. While some progress has been made, like Japan, the U.S. still sought to make progress with China on the principle of national treatment. The next session of U.S.-China BIT negotiations is scheduled for April.

¶16. (SBU) Deputy Assistant USTR for Investment Affairs Josh Kallmer briefed the group on U.S. exploratory talks with Russia and India. Both Russia and India have said they want a BIT with the U.S., but talks have not moved beyond the exploratory phase. Meetings with both countries took place in February, but there is no date yet for follow-on meetings. Talks with Brazil, on the other hand, were at a very preliminary stage. Brazil continues to have both constitutional and political objections to a number of the provisions on the U.S. model treaty. Mita noted Japan had initially considered pursuing a BIT with Brazil, but had ultimately concluded doing so would be too difficult and had abandoned the effort.

Comment

¶17. (SBU) The most significant success of the current round of the IWG was the discussion of Japan's deteriorating investment climate and M&A issues. The GOJ's strong re-affirmation of its pro-FDI policies, including the 2010 FDI target, was a positive step. While METI admitted Japan faces negative market factors and needs to do more to reassure investors -- and acknowledged recent court rulings cases have sowed confusion about Japanese M&A rules -- it remains reluctant to agree to undertake a formal study of the problem or to take specific countermeasures. Nonetheless, with these issues on the agenda, we have a solid basis for continued discussion both in future IWG sessions and through business outreach programs. Pending issues, including labor mobility, Article 821, visas and cargo security were covered in an exchange of papers ahead of the formal session.

Working Group Participants

¶18. (U) USG Participants:
Ambassador Patricia Haslach, Senior Economic Official, East Asian and Pacific Affairs Bureau, State, (co-chair)
Nova Daly, Deputy Assistant Secretary for Investment Security, Treasury
Josh Kallmer, Deputy Assistant U.S. Trade Representative for Investment, USTR
Robert Cekuta, Economic Minister, U.S. Embassy Tokyo
James Zumwalt, Director, EAP/J, State

Stuart Chemtob, Special Counsel for International Trade, Justice
Michael Tracton, Coordinator, Bilateral Investment Treaties,
EEB/OIA, State
Jessica Webster, Economic Unit Chief, EAP/J
David DiGiovanna, Economic Officer, U.S. Embassy Tokyo
Michael Carr, Senior Policy Analyst, Open Investment Policy Group,
Treasury
Chris Winship, Deputy Director, Office of East Asia

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Matthew Poggi, Office of East Asia, Treasury
Tapio Thuomas, Office of Economic Policy, Treasury
Eric Kennedy, Office of Japan, Commerce
Eric Holloway, Director for Japan Affairs, USTR
Ted Bryan, Trade Affairs Officer, EAP/J, State
Meeta Yajnik, Financial Economist, EEB/OIA, State

¶19. (U) GOJ Participants:

Nobuhiko Sasaki, Deputy Director-General, Trade and Economic
Cooperation, METI (co-chair)
Kenji Goto, Commercial Minister, Embassy of Japan
Noriyuki Mita, Director, Americas Division, METI
Hiroaki Niihara, Director, Corporate System Division, METI
Keiichi Kawakami, Director, Trade and Investment Facilitation
Division, METI
Noriyuki Shikata, Director, 2nd North America, MOFA
Satoshi Miura, Economic Counselor, Embassy of Japan
Osafumi Kio, Deputy, Corporate System Division, METI
Shinichi Kihara, Deputy-Director, Americas Division, METI
Kenichi Kobayashi, Trade and Investment Facilitation Division, METI
Yuko Chikazoe, Americas Division, METI
Hiromi Otsuki, Embassy of Japan
Takayuki Kobayashi, Embassy of Japan
Koichiro Nishimatsu, Researcher, 2nd North America, MOFA

¶20. (U) This cable has been cleared in substance with Working Group
participants.

SCHIEFFER